MCDONALD JACOBS
ACCOUNTANTS & CONSULTANTS

2017 Tax Cuts Act: What it Means for Individuals

The Tax Cuts and Jobs Act was signed by President Trump on December 22. The Act makes sweeping changes to the U.S. tax code and impacts virtually every taxpayer. Individuals are more impacted by the provisions of the act than any other class of taxpayer. With the reduction in effective tax rates, the elimination of some deductions, exclusions, and credits coupled with the enhancement of other deductions and credits, individual taxpayers are going to have to navigate a different maze in making decisions to maximize their tax benefits and minimize their tax liability.

The following is a discussion of **select items** that changed as a result of the Tax Cut Act.

Standard Deduction

Provisions of the 2017 Tax Cuts and Jobs Act affecting all individuals is the elimination of the deduction for personal exemptions and the near doubling of the standard deduction. The new standard deduction is $12,000 for single filers, $18,000 for head of household filers and $24,000 for joint filers. The higher standard deduction that replaces the personal exemption, will cut, by more than half, those taxpayers who would otherwise do better by itemizing deductions.

The loss of many itemized deductions will channel an even greater number of taxpayers to the standard deduction. For a large number of taxpayers, their total itemized deductions will no longer exceed the standard deduction.

Mortgage Interest and Medical Deductions

There are new limits of $750,000 on mortgage debt for purposes of the mortgage interest deduction. This new limit applies to debt incurred after December 15, 2017. In the case of acquisition indebtedness incurred before 12/16/17, this limitation is $1 million. Interest expense related to home equity indebtedness used for home improvements incurred prior to 12/31/17 up to $100,000 is still deductible. However, interest expense related to home equity indebtedness used for other purposes may not be deductible. The threshold for medical expense deductions is lowered to 7.5 percent of adjusted gross income (AGI) for tax years 2017 and 2018 and casualty losses will only be allowed for losses in federally declared disaster areas.

State and Local Taxes

Annual itemized deductions for all state and local taxes, including property taxes, is capped at $10,000. This will have a significant impact for residents of Oregon since we have one of the higher state income tax rates.

Miscellaneous Itemized Deductions Eliminated

Under pre-Act law, taxpayers were allowed to deduct certain miscellaneous itemized deductions to the extent they exceeded, in the aggregate, 2% of the taxpayer's adjusted gross income. These deductions included such items as unreimbursed employee business expenses, investment advisory fees, tax preparation fees, safety deposit boxes and certain legal fees.

Under the new law, for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2% floor is suspended.

Child Tax Credit

In contrast, the enhanced child credit has been highlighted as one of the provisions that will lower overall tax liability for middle-class families. The Tax Cuts and Jobs Act temporarily increases the current child tax credit from $1,000 to $2,000 per qualifying child. Up to $1,400 of that amount is refundable. The child tax credit is also expanded to provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children. More families will be able to take advantage of the credit due to an increase in the adjusted gross income phase-out thresholds, starting at $400,000 for joint filers ($200,000 for all others).

Kiddie Tax

The Act simplifies the tax on the unearned income of children by applying ordinary and capital gain rates applicable to trusts to the net unearned income of a child. The taxable income attributable to earned income is taxed according to an unmarried taxpayers' rates. This is in contrast to the current system of taxing children's unearned income at their parent's tax rate.

Roth Recharacterizations

The Tax Cuts and Jobs Act repeals the special rule permitting recharacterization of Roth conversions for tax years beginning after December 31, 2017.

Alternative Minimum Tax (AMT)

For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act increases the AMT exemption amounts for individuals has been increased. Many higher income taxpayers in Oregon have been paying AMT tax because AMT tax does not allow a deduction for state and local taxes, nor personal exemptions. Because the state and local tax deduction has now been limited to $10,000, personal exemptions have been elimination and with the new higher AMT income exemption amount, fewer Oregonians be likely to pay AMT taxes.

Alimony Deduction by Payor/Inclusion by Payee Eliminated

Under pre-Act law, alimony and separate maintenance payments were deductible by the payor and included in income by the recipient spouse. Under the new law, for any divorce or separation agreement executed after Dec. 31, 2018, or executed before that date but modified after it (if the modification expressly provides that the new amendments apply), alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse.

Exclusion for Moving Expense Reimbursements and Moving Expenses Deduction Eliminated

For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the exclusion for employer paid qualified moving expense reimbursements is suspended as is the deduction for moving expenses, except for members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

Expanded Use of 529 Account Funds

Under pre-Act law, funds in a Code Sec. 529 college savings account could only be used for qualified higher education expenses. If funds were withdrawn from the account for other purposes, each withdrawal was treated as containing a pro-rata portion of earnings and principal. The earnings portion of a nonqualified withdrawal was taxable as ordinary income and subject to a 10% additional tax unless an exception applied.

"Qualified higher education expenses" included tuition, fees, books, supplies, and required equipment, as well as reasonable room and board if the student was enrolled at least half-time. Eligible schools included colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education. This included nearly all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions.

Under the new law, for distributions after Dec. 31, 2017, "qualified higher education expenses" ***include tuition at an elementary or secondary public, private, or religious school***, up to a $10,000 limit per tax year.

In Closing

These are just highlights of the changes and impact of the Tax Cuts and Jobs Act. There is much more to discuss than can be covered in this release, including changes to the charitable contributions, ABLE accounts, and the individual mandate, to name a few. Tax reform is further complicated because many of the changes are temporary, generally ending after 2025. Therefore, a comprehensive tax plan must be flexible and anticipate either expiration of these changes or possible extenders in years to come.

We are focused on the immediate and long-term impact of the Tax Cuts and Jobs Act on your situation. Please call our office for guidance on all of the provisions that directly affect you.